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200779—41

In the Supreme Court of the United States

OCTOBER TERM, 1941

No. 171

HADEN COMPANY, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The memorandum opinion of the Board of Tax Appeals (R. 14–18) is unreported. The opinion of the Circuit Court of Appeals (R. 44–47) is reported in 118 F. (2d) 285.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered March 19, 1941 (R. 48). Taxpayer filed a petition for rehearing on April 7, 1941 (R. 49–59), which was denied May 10, 1941 (R. 60). The petition for a writ of certiorari was filed

June 16, 1941. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

QUESTION PRESENTED

The taxpayer was organized as a retail outlet for the X corporation, both companies having the same stockholders, officers, and directors. The taxpayer was indebted to the X corporation for materials purchased and for rent of premises occupied by it. Since the taxpayer was on an accrual basis, the amounts which it owed to the X corporation for materials and rent were deducted by it as business expenses for the years when the indebtedness was incurred. During the taxable year, the X corporation cancelled the indebtedness, thereby rendering the taxpayer solvent. The question is whether the taxpayer realized taxable income through the cancellation of the indebtedness.

STATUTE AND REGULATIONS INVOLVED

Revenue Act of 1934, c. 277, 48 Stat. 680:

> SEC. 22. GROSS INCOME.
>
> (a) General Definition.—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real

or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. In the case of Presidents of the United States and judges of courts of the United States taking office after June 6, 1932, the compensation received as such shall be included in gross income; and all Acts fixing the compensation of such Presidents and judges are hereby amended accordingly.

* * * * *

(U. S. C., Title 26, Sec. 22.)

Treasury Regulations 86 [as amended by T. D. 4871, 1938–2 Cum. Bull. 130, 133]:

ART. 22 (a)–14.—*Cancellation of indebtedness.*—(a) *In general.*—The cancellation of indebtedness, in whole or in part, may result in the realization of income. If, for example, an individual performs services for a creditor, who in consideration thereof cancels the debt, income in the amount of the debt is realized by the debtor as compensation for his services. A taxpayer realizes income by the payment or purchase of his obligations at less than their face value. (See article 22 (a)–18.) If a shareholder in a corporation which is indebted to him gratuitously forgives the debt, the transaction amounts to a contribution to the capital of the corporation.

STATEMENT

The facts as found by the Board of Tax Appeals (R. 14–16) may be summarized as follows:

The W. D. Haden Company (hereinafter called W. D. H. Co.) of Galveston, Texas, is a corporation which for many years has produced sand, gravel, and shell for construction work. It wanted a Houston retail outlet which could handle its own and other building supplies. Its own retailing authority being limited, the taxpayer corporation, The Haden Company, was organized in 1929. The stockholders, directors, and officers of the taxpayer and W. D. H. Co. are identical, although the proportionate individual interests of the stockholders in the two corporations vary somewhat (R. 14–15).

During the four or five years prior to December 31, 1935, the taxpayer had lost heavily, and on that date owed W. D. H. Co. $295,973.16, of which $11,374.11 represented current bills, $151,665.36 loans by W. D. H. Co. to the taxpayer, and $132,933.69 amounts due W. D. H. Co. for rent and materials furnished. Taxpayer then had assets of $149,644.98 and debts of $317,337.49, the deficit being $167,692.51 (R. 15).

At the end of 1935 W. D. H. Co. cancelled all of the taxpayer's debt to it except the $11,374.11 representing current bills. The total owed by taxpayer to all creditors was thus reduced to

$32,738.44, leaving it with net assets of $116,906.54 (R. 15–16).

Before cancellation of its debt to W. D. H. Co. taxpayer was insolvent and unable to carry on business without the assistance of W. D. H. Co., which extended credit to it and guaranteed its obligations to others. After the cancellation of the debt, taxpayer was able to carry on business upon its own credit and without the financial aid of W. D. H. Co. It continued to buy materials and rent premises from W. D. H. Co. The cancellation left W. D. H. Co. in sound financial condition with net assets of $600,000 (R. 16).

In its tax returns for years prior to 1935, taxpayer, which was on the accrual basis, claimed and was allowed deductions for materials purchased from and rent paid to W. D. H. Co. in the amount of $132,933.69; this amount was never paid in cash, but was represented by the indebtedness to W. D. H. Co., which was cancelled during the tax year. The Commissioner added this amount to the taxpayer's 1935 income (R. 15, 16). The Board of Tax Appeals reduced the addition to $116,906.54, which was the amount of taxpayer's net assets after the cancellation, and found that this amount was income of and not a gift to the taxpayer in 1935 (R. 16–22). Upon appeal by the taxpayer, the Circuit Court of Appeals affirmed (R. 48).

ARGUMENT

The holding of the court below involves no conflict of decisions and presents no question of law calling for review by this Court. The decision represents rather the application to the particular facts of this case of principles which are well established.

1. The Board found that the taxpayer received income only in an amount equal to the net worth created by the debt cancellation. Prior to the debt cancellation, the taxpayer was insolvent; after the cancellation, the taxpayer had net assets of approximately $117,000. This sum was properly regarded as taxable income, for the decisions of this Court make plain that a debtor who settles for less than the full amount of his debt, or who otherwise pays or satisfies his obligations at less than their face value, realizes income, at least unless he remains insolvent after the settlement. *United States* v. *Kirby Lumber Co.*, 284 U. S. 1; *Helvering* v. *American Chicle Co.*, 291 U. S. 426; cf. *Walker* v. *Commissioner* 88 F. (2d) 170 (C. C. A. 5th), certiorari denied, 302 U. S. 692.

Taxpayer seeks to avoid this rule on the ground that the transaction here was a gift. But the Board of Tax Appeals found as a fact that the cancellation of the debt was not a gift and the Circuit Court of Appeals approved that finding. Since the determination of this question must turn upon the particular facts of this case, the contro-

versy is not one which calls for review by this Court. In any event, the finding is fully supported by the record. The taxpayer and the creditor had common stockholders and the taxpayer was organized to serve the creditor in the conduct of its business. Accordingly the creditor clearly had an incentive to cancel the debt beyond the satisfaction which flows from the performance of a generous act.

2. The decision below may be supported on an additional and independent ground. A sum in excess of the income resulting from the debt cancellation has been deducted by the taxpayer, which was on the accrual basis, in computing its income taxes for prior years. These deductions represented accruals of accounts payable for rent and materials. The effect of the debt cancellation was to reverse these accruals. Since the taxpayer avoided income tax in prior years by accruing items which it did not pay, it must be deemed to have received taxable income in the year in which its obligation to make the payments was cancelled. Cf. *Maryland Casualty Co.* v. *United States,* 251 U. S. 342, 352; *Walker* v. *Commissioner, supra; Putnam Nat. Bank* v. *Commissioner,* 50 F. (2d) 158 (C. C. A. 5th); *Helvering* v. *Jane Holding Corp.,* 109 F. (2d) 933 (C. C. A. 8th), certiorari denied, 310 U. S. 653; *Chicago R. I. & P. Ry. Co.* v. *Commissioner,* 47 F. (2d) 990 (C. C. A. 7th), certiorari denied, 284 U. S.

618; *Charleston & W. C. Ry. Co.* v. *Burnet*, 50 F. (2d) 342 (App. D. C.).

CONCLUSION

It is respectfully submitted that the petition for a writ of certiorari should be denied.

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